

Disclaimer: this is not legal advice

How to Form a Nonprofit Corporation: Workshop Outline

Thomas P. Holland, Ph.D.

Institute for Nonprofit Organizations

University of Georgia

www.uga.edu/nonprofit

I. **Preparatory steps** (none of this is required of religious organizations or those that have and plan to continue annual income under \$5,000)

A. Should we try to start a new nonprofit?

Pros

- exemption from federal and state taxes on net gains and on property
- donors can claim deductions on their income taxes (not including portion going for benefits in return)
- discounts on postal rates
- public credibility

Cons

- non-distribution of surpluses
- loss of control to board; public access to financial information
- limitations on lobbying and political campaign activities (public education efforts not restricted)
- must continue to get an average of at least 33% of income from public sources (donor contributions and govt. grants)

B. What type of nonprofit should we be?

Go to IRS web site (www.irs.gov) and enter publication 557 in the search box. Print and read this document. It is a good overview of the

whole process of dealing with IRS on this matter. Be sure to decide which IRS type or classification your organization's purpose fits (see chart on pages 57-58 of this document and the definitions of each in the narrative). Read carefully pages 1-33, 43-44, and other sections applicable to the type of organization you are establishing.

- C. Convene a small group of people who are sufficiently committed to the mission to agree to constitute a board for the organization.

- D. By-Laws: Have a sub-group draft a statement of the organization's mission, goals and purposes, name, structure, officers, duties & responsibilities, etc. This is likely to take longer than you may expect, due to the multiple perspectives on the issues to be addressed. Adapt ideas and wording from by-laws of other organization. The board ratifies and records this action in minutes of an official meeting. Then be sure to use the conclusions in this document consistently across all forms and steps that follow.

For example:

Article 1: General

- A. The official name of this organization is....
- B. Principle office is located at (address, city, and county)
- C. Purpose and activities: These by-laws provide for the governance of this corporation, an organization as defined under Section 501(c)(x) of the U.S. Internal Revenue Code. The purpose of this organization is to..... The major activities it will engage in include..... The organization will not engage as a substantial part of its activities efforts to influence legislation or participate in political campaigns. Likewise, no part of its earnings will inure to the benefit of any private shareholders or individuals.
- D. Registered office and agent: (location and name)

Article 2: Membership: This organization shall/shall not have members

Article 3: Board of Directors

- A. Powers and duties of the board include.....
- B. Number and terms of office
- C. Elections
- D. Renewal, resignations or disqualification
- E. Place and times of meetings
- F. Special meetings and notices
- G. Quorum
- H. Compensation of board members (not)
- I. Actions taken by board (binding on whole org.)
- J. Committees (include nomination committee)

Article 4: Officers

- A. Number, titles, roles, terms & limits
- B. Elections
- C. Removal for cause
- D. The President (or Board Chairperson): functions & duties
- E. Vice President (or Vice Chairperson)
- F. Secretary
- G. Treasurer

Article 5: Executive Director

(how selected, duties & responsibilities, compensation)

Article 6: Finances

- A. Fiscal year (July-June, October-Sept., Jan.-Dec.)
- B. Funds of the organization (how structured, budgeted & managed, method of accounting)
- C. Financial statements (balance sheets, due dates, audits)
- D. Disbursements and authority to approve
- E. Donated services (by directors & officers, how valued)

Article 7: Dissolution (what other nonprofit organization gets our remaining resources if/when we go out of business?)

Article 8: Nonprofit activities: (to include only those that serve the specific goals and purposes of the organization; any activities not authorized under section 501(c)(3) will not be conducted)

Article 9: Miscellaneous

- A. Books and records (how kept)
- B. Contracts (board authorization required)
- C. Gifts
- D. Notices
- E. Amendments to By-laws
- F. Indemnification
- G. Conflicts of law (in which case, these by-laws will prevail)
- H. Conflicts of interest

Certifying signatures, names, titles, dates

E. Draft Articles of Incorporation: this is another formal document that will be needed in subsequent steps. Board ratifies and records this action in minutes of a formal meeting.

See guidelines at www.legis.state.ga.us/legis/2003_04/gacode/14-3-202.html

For example:

1. Article 1: Name of the corporation is _____
2. Article 2: The corporation is organized pursuant to the Georgia Nonprofit Corporation Code.
3. Article 3: Street address of organization is _____
The registered agent is _____
The county of the registered office is _____
4. Article 4: The purpose of this organization is _____

The organization will not engage as a substantial part of its activities efforts to influence legislation or participate in political campaigns. Likewise, no part of its earnings will inure to the benefit of any private shareholders or individuals. The organization will not engage in discrimination based on race, ethnicity, gender, religions affiliation.....

5. Article 5: The names and addresses of the incorporators are _____
6. Article 6: The corporation (will/will not) have members.
7. Article 7: The principal mailing address of the corporation is _____

In witness whereof, the undersigned has executed these Article of Incorporation on this _____ day of _____, 2003.

(signature and capacity in which this person is signing)

II. **U.S. Internal Revenue Service (www.irs.gov)**

- A. **Name:** make sure the name you propose for the organization is not already being used. Go to www.irs.gov and enter 78 in the search box for publications. In the section for exempt organizations, enter in the search box the name you want. Submit it for a search to see if there already is an organization using that name. If yes, find a new name and re-try the search process to see if it is already in use.
- B. **Employer Identification Number:** Go back to IRS web site. Enter SS-4 in forms search box. Get, complete and submit IRS Form SS-4 .
(If you haven't done so already, get access to a typewriter for this and many of the other forms that follow, as only a few can be completed on-line.)

- C. Application for exemption: Go back to IRS home page. If this is intended to be a charitable service organization—501(c)(3)-- enter 1023 in forms search box. (If it is an association, enter 1024.) Get and print out Form and instructions for completing it. This is the application for recognition as an organization exempt from federal taxes. The form asks many questions about the organization, its mission, purposes, activities, sources of financial support, officers and contact information, relationships with other organizations, etc. The instructions accompanying the form explain what is needed at each step. (Most of the things you will have already answered in your earlier work on by-laws.) The form also requires your best estimates on this year's budget and projected budgets for the coming 2 years.
- D. Enter 8718 in search box on IRS home page. Get, print and fill out this form. It also gives instructions on where to submit 1023 (I.R.S., P.O. Box 192, Covington, Ky. 41012-0192) and fee (\$500 if projected annual budget is \$10,000 or more and \$150 if less), check payable to U.S. Treasury. Complete this form and attach 1023 plus copies of by-laws, articles of incorporation, completed form 872-C (included in package 1023), and response to SS-4.
- E. IRS will review and respond, either with request for clarification of information submitted or with a "determination letter," granting temporary 501(c)(3) status. This allows organization to proceed with all other steps, including filing with the Georgia Secretary of State.

Note: Having this letter is necessary before any contributors can deduct their contributions to this organization from their own federal income taxes. (You must give written receipts to donors of \$250 or larger for documentation of their contributions.) Also, this letter does NOT exempt the organization's employees from federal and state income taxes and withholdings, Social Security and Medicare

payments; nor the organization from withholdings at federal and state levels, state workers compensation insurance and unemployment taxes (get information about these matters from IRS and from Georgia Dept. of Revenue, 404-417-4490 and get forms at www2.state.ga.us/departments/dor/forms.shtml)

- F. Must complete and submit IRS Form 990 (annual summary of finances) every year thereafter. Get this form also at www.irs.gov, search for form 990. These financial reports must also be submitted to the Ga. Secretary of State, made available for public inspection, and copies available at cost upon request from anyone.
- G. After 2-3 years, IRS will notify org. of final determination of status.
- H. If organization gets any income from a subordinate for-profit, get IRS publication 598 regarding taxes due on unrelated business income.

III. Georgia Secretary of State (www.sos.state.ga.us/corporations)

Note: These regulations and forms differ across states. If your organization will operate within and outside of Georgia, you must file appropriate forms in each of those other states. Don't expect reciprocity.

- A. Reservation of organization's name: get this form from www.sos.state.ga.us/cgi-bin/namerequest.asp Complete it, submit it, and keep the response for attachment with subsequent form 227.
- B. File organization's Articles of Incorporation, following guidelines in Georgia Code section 14-3-202
www.legis.state.ga.us/legis/2003_04/gacode/14-3-202.html

Send a signed copy of organization's Articles of Incorporation to Office of the Georgia Secretary of State, Corporations Division, 2 MLK, Jr. Dr., Suite 315 West Tower, Atlanta, Ga. 30334

- C. Complete and submit Form 227 and Form 3605 to same address. Get Form 227 at www.sos.state.ga.us/corporations/forms.html
Get form 3605 (application for exemption from state corporate taxes) at www2.state.ga.us/departments/dor/forms.shtml
(Click on corporate, scroll down to form 3605). With these completed forms, also attach the response to the name reservation request, Articles of Incorporation, By-laws, a copy of the response to E.I.N. application (SS-4), a copy of the determination letter from IRS, and \$100.00 fee (check payable to Ga. Secretary of State). Mail these to the same address as in step III B.
- D. Subsequent annual registrations of this organization are required every year (\$25.00 fee). Get this form at www.ganet.org/sosonline or www.sos.state.ga.us/corporations/annual_registration_qa.htm
Include completed copy of IRS Form 990 with these annual registrations to the Georgia Secretary of State.
- E. The next business day after submitting Form 227, the organization must publish an intent to incorporate in the newspaper that carries official, legal notices in the county where the office of the organization is located. This should read:

Notice of Incorporation

Dear Publisher: Please publish once a week for two consecutive weeks a notice in the following form. Enclosed is a check in the amount of \$40.00 in payment of the cost of publishing this notice.

Notice is hereby given that articles of incorporation that will incorporate (name of organization) have been delivered to the Secretary of State for filing in accordance with the Georgia Nonprofit Corporation Code. The initial registered office of the corporation is located at (address) and its initial registered agent at such address is (name).

Signature, title, and date

- F. Prior to any public solicitation of funds, organization must file Charitable Solicitation Registration (Form C-100), available at www.sos.state.ga.us/securities/forms/html
- G. Set up systems for employee income taxes at both federal (IRS) and state levels (contact Ga. Dept. of Revenue at 404-651-4490 for instructions and get form CRF-002).

IV. **Local**

- A. Apply with local government for business license and check on zoning regulations where the organization's office is located.
- B. Apply with local property tax assessor for exemption from local property taxes
- C. Apply at Post Office for nonprofit bulk mail status (form PS-3624)

V. **Set up Operations**, including such matters as

- A. Employee policies and benefits, job descriptions, accountability
- B. Systems for employee payroll, benefits, federal and state income taxes and withholdings, state workmen's compensation and unemployment
- C. Bank account, office space, rent, utilities, supplies, equipment, letterhead
- D. Computer systems for word processing, accounting, record-keeping

- E Directors and officers insurance and business liability insurance
- F. Orientation sessions for board and staff

V. **References and resources** for additional information about establishing nonprofit corporations

Deja, S. Prepare Your Own 501(c)(3) Application. P.O. Box 75012, Seattle, Washington 98125, 2002. (c3book@aol.com)

The following booklets are all available from BoardSource, Washington, D.C. (www.boardsource.org)

Albert, S. Hiring the Chief Executive. 2000.

Berger, S. Understanding Nonprofit Financial Statements. 2003.

Fletcher, K. The Policy Sampler: A Resource for Nonprofit Boards, 2000.

Hirzy, E.C. Nonprofit Board Committees. 1992.

Hopkins, B.R. Legal Responsibilities of Nonprofit Boards. 2003.

Johnson, J. Turning Vision into Reality: What the Founding Board should Know about Starting a Nonprofit Organization. 1999.

Lakey, B. Nonprofit Governance, 2000.

Tesdahl, D.B. The Nonprofit Board's Guide to By-laws. 2003.

Other useful web sites:

www.managementhelp.org/strt_org/strt_org.htm

www.drcharity.com/npstart.html

www.gvsu.edu/philanthropy/pdfs/npstartup.pdf

groups.yahoo.com/group/starting-nonprofit

STEPS TO NONPROFIT INCORPORATION

Arrange for Incorporators

Usually the founders of the organization.

Complete the Application for Reservation of Name

As soon as you have decided upon the name you desire to give your nonprofit organization, it is a good idea to file that name with the Michigan Department of Consumer and Industry Services, by filling out the Application for Reservation of Name form. In that way, you are protecting the name, while making sure that no one else currently has it, as well as guaranteeing that no one chooses that name before you become incorporated.

Draft the Articles of Incorporation

Incorporation is a state process that legally forms a separate legal entity through which the nonprofit organization operates. It serves to protect the individuals within the group with limited liability. The process of incorporation is not a lengthy one, but one which requires careful preparation and filing of certain documents with the Secretary of State. In addition, it requires the formation of a board of directors, appointment of officers, adoption of bylaws and other procedural requirements, such as annual meetings. Once prepared, these papers should be signed by the required number of incorporators and returned to the **Michigan Department of Consumer and Industry Services, Bureau of Commercial Services, Corporation Division, P.O. Box 30054, Lansing, MI 48909**; the cost is \$20.00. This provides the State with information on where to contact the organization, what the organization does, and how it is funded. The statement of purpose within this document is what separates nonprofit from for-profit corporations. (See page 13 for more information.)

Select the Board of Directors

In most cases at least three adults who are U.S. citizens serve as the initial Board of Directors. The incorporators may also be named as directors; they need only serve in this capacity until the first annual meeting. The Board of Directors includes, but is not limited to the: President, Vice-President, Secretary and Treasurer. (Refer to the checklist on page 20.)

Charitable Solicitation

Organizations that expect to or actually receive \$8,000 or more per year from the public (other than grants from foundations or government agencies) for a charitable purpose, and by any professional fundraisers they employ, must obtain a license to solicit. Applications should be submitted to the Attorney General, State of Michigan at least 30 days before solicitation begins; there is **no** fee. The application can be obtained from: **Office of the Attorney General, Charitable Trust Section, P.O. Box 30214, Lansing, MI 48909.** (517) 373-1152.

Federal Employer Identification Number (FEIN) - All corporations whether or not they have employees, need a federal EIN. An organization uses the EIN for identification purposes, much as an individual uses a social security number. By applying for a FEIN, you then become listed in the IRS computer. If you hire staff, you must: keep payroll records; file periodic payroll reports; deposit payroll taxes; fill out a W2 form, obtain employment eligibility verification, and maintain reports for each employee; and comply with a number of other state and local requirements as dictated by law. To apply, use form SS-4, "Application for Employer Identification Number." Most forms are available at local IRS offices in larger cities, or call 1-800-829-3676.

Federal Tax Exemption

Section 501(c) of the Internal Revenue Code contains provisions for tax exemption for a number of categories of nonprofits. Tax exemption means not having to pay federal corporate income tax and Michigan's Single Business Tax.

A nonprofit should apply to the IRS for 501 status within 15 months after the end of the month in which it was incorporated. Religious organizations are usually exempt automatically without applying and organizations whose gross receipts are normally \$5,000 a year or less are automatically exempt. Two application forms are currently available that allow nonprofit organizations to apply for tax exemption under Internal Revenue Service Code. Those are:

Package 1023, *Application for Recognition of Exemption*, is used by charitable organizations defined under IRS code 501(c)(3). Charitable organizations are those that include relief for the poor, distressed or underprivileged; advancement of religion; advancement of education or science; erection/maintenance of public buildings, monuments or works; decreasing government burdens and neighborhood tensions; eliminating prejudice and discrimination; defense of human and civil rights secured by law; combating community deterioration and preventing juvenile delinquency. In addition, the following organizations will also use Form 1023: 501(e) and (f) Cooperative Service Organizations, section 501(k) Childcare Organizations, and section 501(n) Charitable Risk Pools.

Package 1024, *Application for Recognition of Exemption*, is used for other tax-exempt organizations that fall under the 501(a) Internal Revenue Code, specifically organizations described in sections: 501(c)(2), (4), (5), (6), (7), (8), (9), (10), (13), (15), (17), (19), and (25). For example, the following types of organizations would file the 1024: Civic Leagues, Social Welfare Organizations, Labor, Agricultural, and Horticultural Organizations, Chambers of Commerce, Trusts with Multiple Parents, and Local Associations of Employees.

In addition, a few types of organizations are not required to submit specific application forms. For more details regarding the tax-exempt status of your organization, refer to the "Organization Reference Chart" enclosed in Publication 557 (located in the tax form section of the nonprofit startup kit) from the IRS entitled, *Tax-Exempt Status for your Organization*.

Either package requires detailed information about organizational history, projects, fundraising, structure, finances, and copies of articles of incorporation, bylaws and other important documents. IRS form 8718, "User Fee for Exempt Organization Determination Letter Request," and the required fee (\$150 if gross receipts will be \$10,000 a year or less, and \$500 if gross receipts will be over \$10,000) must also be enclosed. You should note that the entire IRS decision-making process can take anywhere from four months to a year to complete. However, the organization can still accept tax-deductible donations while IRS approval is pending.

Application for tax exemption is complex; nonprofit leaders who are inexperienced should seek experienced professional review of the application before filing. Application forms are available at the address cited in the Checklist for Organizing a Nonprofit.

Other Tax Exemptions

It should be noted that the 501(c)(3) status relates only to federal income tax. If your organization has real estate used in its exempt purpose, you will have to contact the taxing authority to obtain a property tax exemption. Sales and use tax exemptions are governed by State law.

Sources:

Alliance for Nonprofit Management -

Aspen Institute -

Foundation Center -

Innonet -

MAP for Nonprofits -

Michigan Nonprofit Management Manual, Accounting Aid Society, Third Edition.

Outline of Government Reporting and Tax Requirements for Michigan Nonprofit

Organizations, Consumer Consulting Associates, East Lansing, MI.

The Complete Guide to Nonprofit Corporations, Ted Nicholas Enterprise, Dearborn, MI.

STEPS FOR ORGANIZING A NONPROFIT, TAX-EXEMPT ORGANIZATION

Determine Purpose & Structure

Hold a general, and possibly informal, meeting to establish a consensus on the purpose and structural form of the proposed organization. Delegate individuals or committees the responsibility of drafting bylaws, filing Articles of Incorporation, planning activities and developing a budget and fundraising plan.

Incorporate

The primary governing documents for the organization are the Articles of Incorporation and the Bylaws. File Articles of Incorporation as a domestic, nonprofit corporation with the State of Michigan. The filed Articles of Incorporation will be returned within a few weeks. The individual or individuals who sign the Articles of Incorporation are called the incorporator(s). The role of the incorporator(s) is to prepare and file the Article of Incorporation and also designate the initial members of the Board of Directors. Additionally, the incorporator(s) may adopt the proposed Bylaws.

File SS-4

Federal Form SS-4 is to obtain an employer identification number (EIN). This number is generally required to open a bank account and is the official number for the organization.

Draft Articles of Incorporation and Bylaws

Prepare Bylaws that will state the membership/board rights and requirements, the process for selecting board members and officers, their duties and powers, and the controls placed on the disbursement of funds.

Draft Activity Plans and Budget

Prepare activity plans to achieve the purpose/mission of the organization with a preliminary budget identifying the income and expenses for the first two (2) years of operation.

Conduct Organizational Meeting

After the Articles of Incorporation have been filed, hold a more formal organizational meeting of the designated board members to:

- Accept the Articles of Incorporation as filed
- Adopt the proposed Bylaws with necessary amendments
- Elect officers pursuant to the Bylaws
- Authorize necessary financial transactions
- Authorize a person to prepare and apply for tax exemption
- Consider the proposed activity plans/budgets and recommend revisions

Determine Fiscal Year

Establish a fiscal year that ends during a natural break in the organization's activities. If possible, coordinate the end of the fiscal year with major funding sources. The fiscal year must end on the last day of the month.

Establish Accounting System

An accounting system should be established to record the receipt and expenditure of money in accordance with the Bylaws and with the reporting requirements that will be imposed on the organization by funders and governmental units.

Establish Corporate Record Books

Establish a system for preserving corporate documents such as Articles of Incorporation, Bylaws and amendments, and the minutes of board meetings, committee meetings and the meeting(s) of the incorporator(s).

Begin Program Activities

Program activities may be started at any time depending on the solidification of the organization's plans and the availability of resources. However, individual participants are more likely to be held personally liable for organizational debts incurred before incorporation than those incurred after incorporation.

Additional Employer Registration

If the organization intends to hire employees, register with the appropriate state and local governmental agencies for withholdings required for income and unemployment taxes. Also subscribe to worker's compensation insurance and health insurance for employees.

File Form 1023 for 501(c)(3) Status

File a 1023 application with the IRS to obtain the 501(c)(3) exemption for corporate income taxes and the right of deductibility for charitable contributions of donors. This application should be filed within fifteen (15) months of the time of organization and at least two (2) or three (3) months before the organization hopes to obtain any grants from foundations or large contributors. There is an application fee to apply for 501(c)(3) status. Form 8718 is the required transmittal form. If an organization's annual revenue is expected to be less than \$5,000, the IRS does not require that the 501(c)(3) application be filed.

Register as a Charitable Trust

File an Initial Charitable Trust/Charitable Solicitation Questionnaire, a Charitable Trust Registration Statement, and a Charitable Trust Inventory with the State within sixty (60) days of the time the organization first receives funds for charitable purposes. United Way agencies, hospitals, and some educational organizations are exempt from this requirement.

Solicitation of Small Donations

Solicitation of small donations and membership may occur before obtaining the 501(c)(3) tax-exemption as long as the donors are willing to risk the organization's inability to qualify for exemptions. If the organization qualifies within fifteen (15) months of incorporation, the deductibility of donor contributions will be recognized retroactively.

Solicit Private Grants

Solicitation of corporate and foundation grants, as well as large contributions, will be largely unsuccessful prior to receipt of an IRS letter recognizing the organization's 501(c)(3) tax-exempt status.

Revise Activity Plan and Budget

Revise the organization's activity plan and budget for the first two (2) years after the organization has had some initial experience with the cost of staff and activities, and an opportunity to test funding opportunities. This will help set priorities for the use of resources and will serve as a supporting document for tax exemption applications and for funding proposals. The revised plan and budget should be submitted to the board (and/or membership) for approval.

Apply for Nonprofit Bulk Mail Rates

Apply for reduced rates at the post office. Having received IRS recognition as a 501(c)(3) tax-exempt organization will facilitate the application.

File for Property Tax Exemption

Apply with the local tax assessor for exemptions from local taxes on any real and personal property held by the organization. These applications should be made before taxes are assessed, since obtaining retroactive exemptions is frequently difficult.

Sales Tax Exemption

Applying for sales tax exemption from the State of Michigan is no longer necessary. Instead, complete the Michigan Sales and Use Tax Certificate of Exemption for each vendor and keep a copy of the IRS letter recognizing the organization's 501(c)(3) tax-exempt status on hand.

Obtain Liability Insurance

Consider insurance policies to cover the organization's property, if it is substantial, and to cover the organization and its directors and officers against possible personal injury suits by clients or guests.

Prepare State Annual Statements and Reports

At the end of the first fiscal accounting year (the first may be less than twelve (12) months), prepare a statement of receipts and expenditures. In addition, the State of Michigan will require a completed Michigan Nonprofit Corporation Information Update Form on an annual basis. They will provide you with the necessary form, which is due before October 1 of each year. The filing fee is \$10.

Source:

Getting Started: A Guide to Starting a Nonprofit, Tax-Exempt Organization in the State of Michigan, Accounting Aid Society.